

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
B & P REALTY ASSOCIATES	:	DETERMINATION
	:	DTA NO. 809560
for Revision of a Determination or for Refund	:	
of Tax on Gains Derived from Certain Real	:	
Property Transfers under Article 31-B of the	:	
Tax Law.	:	

Petitioner, B & P Realty Associates, c/o Joseph Hershkowitz, Esq., 319 Fifth Avenue, New York, New York 10016, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

A hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on February 10, 1993 at 1:00 P.M. Petitioner submitted additional documents on March 11, 1993 and on March 16, 1993. The parties submitted a stipulation of facts on May 11, 1993. Briefs were filed by petitioner and the Division of Taxation on June 16, 1993 and July 20, 1993, respectively. The record was then left open until September 3, 1993 for the submission of a reply brief by petitioner; however, one was not filed. Petitioner appeared by Howard Koff, Esq., and Brian Gledhill, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly determined that a purchase money mortgage received as consideration in exchange for the assignment of a contract for real property should be valued at its face amount although the mortgagor defaulted on the note before making any payments of the principal.

II. Whether petitioner has shown that any failure to comply with the provisions of Article 31-B of the Tax Law was due to reasonable cause and not willful neglect so as to warrant the

cancellation of penalty.

FINDINGS OF FACT

Petitioner, B & P Realty Associates, and the Division of Taxation ("Division") executed two stipulations of fact which were made a part of the record of this proceeding. The facts stipulated to have been incorporated into these Findings of Fact.

The real property which is the subject of the transfer at issue here is located at 14 Lafayette Square in Buffalo, New York and is commonly known as the Rand Building. On August 21, 1986, Lafayette Square Associates contracted to sell its fee interest in the Rand Building to the Hatoum Corporation which was acting as nominee for a charitable organization, Yeshiva Darkei Emunah.

On or about December 11, 1986, the Hatoum Corporation assigned its rights to purchase the Rand Building to petitioner, and petitioner then transferred its rights to Rand Associates in exchange for \$100,000.00 in cash and a purchase money note and mortgage in the amount of \$1,500,000.00. The mortgage which secured the note was subordinate to a first mortgage held by Lloyds Bank, Plc., in the amount of \$5,250,000.00.

By the terms of the mortgage note, petitioner was to receive "monthly installments of interest only, computed at the rate of 9% per annum, with the first payment due and payable on the 11th day of January, 1987, and monthly thereafter, until the 11th day of December, 1989." The full amount of the principal then became due with one proviso. If the first mortgage was extended for up to two years, the terms of the purchase money mortgage would likewise be extended for two years, contingent upon the payment of \$750,000.00 in reduction of the principal on the third anniversary of the mortgage agreement. Thus, the maximum term of the purchase money mortgage was five years with no payment on the principal amount due or owing until the end of the third year.

No payment of principal was made to petitioner under the terms of the mortgage. In November 1989, Rand Associates defaulted on the first mortgage and foreclosure by the first mortgagee followed. Rand Associates also defaulted on the subordinated mortgage at that time.

In accordance with the terms of the mortgage note, petitioner received monthly payments of interest from Rand Associates until the default occurred.

Petitioner filed a supplemental real property transfer gains tax return in connection with the subject transactions on or about December 11, 1986. It reported gain subject to tax of \$1,575,000.00 with a tax due of \$157,500.00. Petitioner made a payment of \$7,500.00 with the filing of the return and deferred payment of the remaining \$150,000.00 due. A payment in the amount of \$15,000.00 was made on December 11, 1987, and a second payment in the same amount was made on December 11, 1988. No payments were made to the State after that time. In accordance with the gains tax return filed by petitioner, the amount of tax remaining due is \$120,000.00.

The Division issued to petitioner a Notice of Determination dated April 16, 1990, assessing tax in the amount of \$120,000.00, plus penalty and interest. An explanation attached to the notice provides the following information:

"TAX PERIOD ENDED DATE: 12/11/86
FILE DUE DATE: 12/11/86 DATE RECEIVED: 12/11/86

Tax Per Taxpayer:	7,500.00
Tax Per Dept of Tax & Finance:	78,750.00
Timely Payments/Credits:	7,500.00
Late Payments:	0.00
Amount Previously Assessed/Refunded:	0.00
BALANCE:	71,250.00"

"TAX PERIOD ENDED DATE: 12/11/87
FILE DUE DATE: 12/11/87 DATE RECEIVED: 12/11/87

Tax Per Taxpayer:	15,000.00
Tax Per Dept of Tax & Finance:	15,750.00
Timely Payments/Credits:	15,000.00
Late Payments:	0.00
Amount Previously Assessed/Refunded:	0.00
BALANCE:	750.00"

"TAX PERIOD ENDED DATE: 12/11/88
FILE DUE DATE: 12/11/88 DATE RECEIVED: 12/11/88

Tax Per Taxpayer:	15,000.00
Tax Per Dept of Tax & Finance:	15,750.00
Timely Payments/Credits:	15,000.00
Late Payments:	0.00
Amount Previously Assessed/Refunded:	0.00

BALANCE: 750.00"

"TAX PERIOD ENDED DATE: 12/11/89

FILE DUE DATE: 12/11/89 DATE RECEIVED: 12/11/89

Tax Per Taxpayer:	0.00
Tax Per Dept of Tax & Finance:	47,250.00
Timely Payments/Credits:	0.00
Late Payments:	0.00
Amount Previously Assessed/Refunded:	0.00
BALANCE:	47,250.00"

In an affidavit, Arthur H. Judelsohn, a general partner of 14 Lafayette Square Associates, stated his view that the Rand Building was worth \$5,700,000.00 when it was sold in December 1986.

At the hearing in this matter, the Division sought to place in evidence a letter from petitioner's attorney to two individuals representing petitioner. In essence, the letter advised timely payment of the tax installments due to the State. Petitioner objected on grounds of attorney/client privilege. Petitioner requested permission to amend its petition in order to request cancellation of penalties. The Division objected to the amendment. Both objections were withdrawn by stipulation of the parties.

CONCLUSIONS OF LAW

A. Section 1441 of the Tax Law imposes a tax on gains derived from the transfer of real property within New York State. Transfers subject to the tax include any transfer of any interest in real property by any method, including sale, exchange or assignment (Tax Law § 1440[7]). Thus, petitioner's assignment of its contractual rights to purchase the Rand Building was a transfer subject to the gains tax.

The term "gain" is defined in Tax Law § 1440(3) as the "difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price."

"Consideration includes any price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property, or any other thing of value and including the amount of any mortgage, purchase money mortgage, lien or other encumbrance" (Tax Law § 1440[1]; emphasis added).

By the clear wording of the statute, the consideration received by petitioner for the

assignment of its contractual rights to purchase real property included the purchase money mortgage given by Rand Associates to petitioner. In several decisions, the Tax Appeals Tribunal has held that a purchase money mortgage is to be included in consideration at its face value (Matter of Normandy Assocs., Tax Appeals Tribunal, March 23, 1989; Matter of Festival Leasehold Co., Tax Appeals Tribunal, January 20, 1989). In fact, petitioner properly included the purchase money mortgage at its face value in its calculation of consideration received when it filed its supplemental gains tax transferor questionnaire.

Petitioner takes the following position regarding the tax assessment, as expressed in its representative's brief:

"The Department of Taxation and Finance, Division of Taxation (the 'Department'), seeks to impose Gains Tax on Petitioner on illusory 'gain' of \$1.5 million, as represented by the face amount of the Note. As described by Petitioner's representative at the hearing in this matter, the Department seeks to tax Petitioner on pure 'air'.

"The Department's position is utterly inconsistent with the plain meaning of the statute, i.e. that the tax is to be imposed on realized 'gain', and further flies squarely in the face of judicial precedents that have found that the intended purpose of the statute is consistent with its plain meaning, that is, to tax 'gain'." (Petitioner's Brief, pp. 4-5.)

Apparently, petitioner means to argue that events occurring after the transfer, in this case the default on the mortgage in November 1989, affects the value of the consideration received. This argument has been made in prior cases and rejected.

At the time of transfer of the Rand Building, Tax Law former § 1442 provided that the tax imposed under Article 31-B was to "be paid by the transferor . . . on the date of transfer." In Matter of Cheltoncort Co. (Tax Appeals Tribunal, December 5, 1991), the Tax Appeals Tribunal stated:

"In calculating the amount of tax due upon a taxable transaction, the value of the consideration has to be determined at the time of the transfer in order to finally fix the tax owed. Subsequent events do not alter the value that the consideration had at the time of the transfer."

This interpretation of former section 1442 was confirmed by the Appellate Division, Third Department (Matter of Cheltoncort Co. v. Tax Appeals Tribunal, 185 AD2d 49, 592 NYS2d 121). Accordingly, there is no merit to petitioner's contention that the "gain" must be

redetermined in light of subsequent events. The Federal court decision cited in petitioner's brief does not address the issue raised in this proceeding and lends no support to petitioner's position (see, 995 Fifth Avenue Assocs., L.P. v. New York State Dept. of Taxation & Fin., 963 F2d 503, cert denied ___ US ___, 121 L Ed 2d 302). Likewise, the decision of the Court of Appeals in Trump v. Chu (65 NY2d 20, 489 NYS2d 455, appeal dismissed 474 US 915) does not stand for the proposition for which petitioner's representative cited it. In that decision, the Court stated:

"Plaintiffs also contend that the statutory definition of 'original purchase price' does not adequately reflect the basis of the real property and will lead to imposition of the tax when a net loss is sustained. The statute defines 'gain', however, as the difference between 'consideration' (after deduction of brokerage fees) and the 'original purchase price' and the regulations promulgated by the Department of Taxation and Finance to implement the statute make it clear that all customary, reasonable and necessary costs related to the acquisition and improvement of real property are included in the original purchase price so that the tax will be imposed only in the case of a net profit." (Id., 489 NYS2d at 460; references omitted; emphasis added.)

In petitioner's brief, the emphasized language is quoted to support its contention that no gains tax is due because petitioner did not realize a profit on the promissory note. Placed in the context of the entire paragraph in which it appears, it is clear that the Trump decision provides no such support. The Trump opinion defines "gain" as it is defined in the Tax Law: as "the difference between the consideration for the transfer of real property and the original purchase price of such property" (Tax Law § 1440[3]). The question addressed in the Trump opinion is the rationality of the statutory definition of "original purchase", a subject that has no relevancy to this proceeding. Nothing in the Trump decision contradicts the conclusion reached here: in determining the amount subject to tax, the value of the consideration is calculated at the time of the transfer and includes the face value of a mortgage or purchase money mortgage paid.

B. In its brief, petitioner argues that the purchaser's promissory note should be accorded "open transaction" treatment. Petitioner does not fully explain what is meant by this term, and the only citation given, TSB-M-86(4)R, contains no mention of an "open transaction" approach to determining consideration. There is a brief discussion of contingent future payments in the Division's memorandum. The memorandum states:

"Where a contract contains an unvalued benefit or provides for a contingent

payment, the Department will issue either a statement of tentative assessment or statement of no tax due based on the known consideration. An agreement extending the statute of limitation of time for assessment will be required to be filed. If there is additional consideration received for the transfer at a later date, the transferor and transferee, [sic] are required to file updated questionnaires disclosing the actual consideration for the transfer of real property."

In this case, there is no contract containing "an unvalued benefit" or "contingent payment". The consideration to be paid was not "contingent and unknown at the time of the sale" (Petitioner's Brief, p. 7). In fact, the consideration was exact and certain and included the face value of the purchase money mortgage and \$100,000.00 in cash.

C. If it is determined that a failure to pay the gains tax due in a timely fashion is due to reasonable cause and not to willful neglect, the penalty imposed may be abated or waived (Tax Law § 1446[2][a]). Petitioner claims that it reasonably believed that no tax was due because it did not realize any "gain" from the purchase money mortgage. The penalties asserted cannot be waived on this basis.

Petitioner filed a transferor questionnaire reporting a total tax liability of \$157,500.00 based on a cash payment by the transferee of \$100,000.00 and a purchase money mortgage in the amount of \$1,500,000.00. Tax Law § 1442 sets forth several options for payment of the gains tax where, as here, the tax due exceeds 50% of the cash portion of the consideration. Where the cash portion is equal to or less than the tax due the transferor may elect "to pay the lesser of (a) fifty percent of the tax due or (b) such cash portion", and to pay the balance over three years, "or, in the case of a purchase money mortgage given by the transferee to the transferor, the lesser of the term of the purchase money mortgage or fifteen years, in equal annual installments payable on the anniversary date of the transfer" (Tax Law § 1442[c]). If a transferor fails to make any required installment payment on the date due, the Commissioner of Taxation and Finance "may declare the entire unpaid balance of the tax due and owing" (Tax Law § 1442[e]).

On the date of transfer of the Rand Building, petitioner made an installment payment of \$7,500.00. It was required to pay at least \$78,750.00 (50% of the tax due). Of the total amount of tax assessed against petitioner (\$120,000.00), \$71,250.00 is attributable to the failure to

make payment of the tax due on the transfer date. Petitioner gives no reason at all for failing to pay the minimum amount due at the time of the transfer; consequently, there is no basis for waiving the penalty imposed for the failure to pay this amount when due.

The term of the purchase money mortgage given to petitioner was a maximum of five years. Therefore, petitioner was required to make five annual installments of \$15,750.00 in payment of the balance of tax due (\$78,750.00). It made two annual payments of \$15,000.00, and it offers no reason for not paying the full amount. Therefore, the penalty assessed for 1987 and 1988 must be sustained.

Finally, since petitioner failed to make any installment payment on December 11, 1989, petitioner was required to pay the balance due of \$47,250.00. Presumably, it knew by this time that the mortgagee would default on the mortgage. A major consideration in determining whether a taxpayer has acted reasonably is the extent of the taxpayer's attempts to determine its tax liability (Matter of Northern States Contracting Co., Tax Appeals Tribunal, February 6, 1992). There is no evidence in the record to show that petitioner made any attempt to determine its liability for the balance of the tax then due. According to petitioner's brief, "[p]etitioner reasonably, and without wilful [sic] neglect, concluded that it owed no Gains Tax upon the Note since the Note was not paid, was not likely ever to be paid, and no 'gain' was derived therefrom" (Petitioner's Brief, p. 8). There is no evidence in the record of the basis upon which petitioner concluded that no tax was due. Apparently, it made no inquiries to the Division or to its own counsel. Under these circumstances, I cannot find that petitioner acted reasonably.

D. The petition of B & P Realty Associates is denied, and the Notice of Determination issued on April 16, 1990 is sustained.

DATED: Troy, New York
February 3, 1994

/s/ Jean Corigliano
ADMINISTRATIVE LAW JUDGE